CITIES AND REGIONS: HOW DO THEY AFFECT NATIONAL PRODUCTIVITY AND GROWTH?

Department of Infrastructure and Regional Development
20 March 2017

Joaquim Oliveira Martins

OECD Public Governance Directorate
Relative dominance of a small number of cities

60% of jobs are located in 4 cities (Melbourne, Sydney, Brisbane and Perth)

Source: OECD Regional Database
A geography of discontent?

Share of national employment (place of residence) in predominantly rural regions in Australia (TL3) 2000-2016

Source: OECD Regional Database
OECD regional development policy paradigm

Compensating lagging regions does not work:
• Creates dependency, not development
• Wealthier regions may become reluctant to support lagging regions

OECD promotes ‘place-based’ policies focusing on:
• Use of regional specific assets (or create absolute advantages to stimulate competition & experimentation across regions)
• Create complementarities among sector policies at the regional (or local) level
• Use of multi-level governance mechanisms for aligning objectives & implementation
National productivity performance needs the contribution of all regions.
Convergence of countries vs. divergence of regions in the OECD

GDP per capita dispersion is now greater within countries than between countries.
The productivity gap between frontier and lagging regions has increased.

Notes: Average of top 10% and bottom 10% TL2 regions, selected for each year. Top and bottom regions are the aggregation of regions with the highest and lowest GDP per worker and representing 10% of national employment. 19 countries with data included.
Where are Frontier, Catching-up and Diverging regions located?

70% of mostly urban frontier regions contain very large cities

75% of diverging mostly urban regions contain very large cities
What are the main drivers of regional productivity catching-up?
Productivity trends by type of region

Rural remote regions present a higher variation in productivity growth rates than other types of regions

<table>
<thead>
<tr>
<th>Region</th>
<th>Annual average labour productivity growth, 2000-12</th>
<th>Standard deviation</th>
<th>Coefficient of variation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Predominantly urban</td>
<td>1.01%</td>
<td>1.02%</td>
<td>1.019</td>
</tr>
<tr>
<td>Intermediate</td>
<td>1.07%</td>
<td>1.09%</td>
<td>1.024</td>
</tr>
<tr>
<td>Predominantly rural close to cities</td>
<td>1.36%</td>
<td>1.32%</td>
<td>0.972</td>
</tr>
<tr>
<td>Predominantly rural remote</td>
<td>0.70%</td>
<td>1.15%</td>
<td>1.641</td>
</tr>
</tbody>
</table>

Note: Labour productivity is defined as real GDP per employee. GDP is measured at PPP constant 2010 US Dollars, using SNA2008 classification; employment is measured at place of work. The coefficient of variation represents the ratio of the standard deviation over the mean.

Source: OECD Regional Outlook 2016
Catching-up regions are characterised by a stronger intensity of the tradable sectors

All tradable sectors, TL2 regions

Notes: Tradable sectors are defined by a selection of the 10 industries defined in the SNA 2008. They include: agriculture (A), industry (BCDE), information and communication (J), financial and insurance activities (K), and other services (R to U). Non tradable sectors are composed of construction, distributive trade, repairs, transport, accommodation, food services activities (GHI), real estate activities (L), business services (MN), and public administration (OPQ).
To remain competitive in Tradable sectors there are three main options:

1. **Continued specialisation in Natural resources.** This is typically an option for remote rural regions.

2. **Be integrated in Global Value Chains.** Integration between manufacturing and service sectors is needed. Connectivity and proximity may favour low-density areas close to cities. Without a territorial strategy it may be difficult to benefit from GVCs for regional development. Forward and backward linkages (*re-bundling*) are critical to maximize value-added of FDI and creation of a network of local suppliers.

3. **Develop Territorially differentiated products & services** through mobilisation of local assets. Consumers may express preferences for local or traceable products, without subsidies or some form of protection.
# Evolving OECD Rural Policy Paradigm

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Objectives</strong></td>
<td>Equalisation</td>
<td>Competitiveness</td>
<td>Well-being considering multiple dimensions of: i) the economy, ii) society and iii) the environment</td>
</tr>
<tr>
<td><strong>Policy focus</strong></td>
<td>Support for a single dominant resource sector</td>
<td>Support for multiple sectors based on their competitiveness</td>
<td>Low-density economies differentiated by type of rural area</td>
</tr>
<tr>
<td><strong>Tools</strong></td>
<td>Subsidies for firms</td>
<td>Investments in qualified firms and communities</td>
<td>Integrated rural development approach – spectrum of support to public sector, firms and third sector</td>
</tr>
<tr>
<td><strong>Key actors &amp; stakeholders</strong></td>
<td>Farm organisations and national governments</td>
<td>All levels of government and all relevant departments plus local stakeholders</td>
<td>Involvement of: i) public sector – multi-level governance, ii) private sector – for-profit firms and social enterprise, and iii) third sector – non-governmental organisations and civil society</td>
</tr>
<tr>
<td><strong>Policy approach</strong></td>
<td>Uniformly applied top down policy</td>
<td>Bottom-up policy, local strategies</td>
<td>Integrated approach with multiple policy domains</td>
</tr>
<tr>
<td><strong>Rural definition</strong></td>
<td>Not urban</td>
<td>Rural as a variety of distinct types of place</td>
<td>Three types of rural: i) within a functional urban area, ii) close to a functional urban area, and iii) far from a functional urban area</td>
</tr>
</tbody>
</table>
What makes cities more productive?
Sources of agglomeration economies


I. **Sharing facilities, inputs, gains from specialisation**
   firms may face lower costs for specialised non-traded inputs that are shared locally in a geographical cluster.

II. **Thicker labour markets**: labour market **pooling**; better matching
   gain from reduced labour acquisition and training costs in thick local labour markets with abundant specialised labour force

III. **Knowledge spillovers**: learning about and **spreading new ideas**
    face-to-face contact can enable tacit knowledge spillovers through increases in the intensity of the interactions with other firms or individuals
City productivity increases with city size even after controlling for sorting.

Doubling the size of a city ≈ 3-5% productivity increase
Horizontal administrative fragmentation is common as cities outgrow their historic boundaries (more than 10 local governments in 75% of OECD Metropolitan Areas; more than 100 in 22%)

A larger number of local governments may be positive:

- Provide more choice in the provision of public services, more tailored solutions and better accountability (Tiebout, 1956).
- Large literature that finds no scale effects for specific public services (Ostrom, 2010) or governmental expenditure (Kalb, 2010).

But it may also have a potential negative impact:

- Policies, investment and services require city-wide coordination (e.g. Cheshire and Gordon, 1996): e.g. transport; land use; ease of doing business; economic promotion; environmental regulation, etc.
Administrative fragmentation is correlated with lower city productivity.
Land use and cities
Land use policies to foster green and inclusive growth in urban areas

- Need to find a balance between productivity, sustainability, liveability and affordability

- Formal planning instruments can affect productivity directly
  - e.g. via the efficiency of public transport in cities
  - by being slow to respond to change and thereby impeding innovation

- Land use policies are an important tool for making urban productivity and growth greener and more inclusive
Housing costs have risen strongly in most OECD countries.

Inflation-adjusted property prices (1995=100)

The graph shows the inflation-adjusted property prices for various OECD countries from 1995 to 2015. The prices are adjusted for inflation, with 1995 as the base year (100). The countries included in the graph are Australia, Belgium, Canada, Switzerland, Germany, Denmark, Spain, Finland, France, United Kingdom, Ireland, Italy, Japan, Netherlands, Norway, New Zealand, Sweden, United States, and the average for all countries.

Key trends observed in the graph:
- Ireland shows a significant increase in property prices.
- Sweden also exhibits a notable rise in property prices.
- The United Kingdom (UK) shows a moderate rise.
- Japan and Australia have relatively modest changes in property prices.
Overly restrictive land use policies can harm inclusiveness via rising housing costs

- Land use regulations should aim to prevent sprawl…
- …but have to provide sufficient space to construct housing for growing populations
- Otherwise, housing costs rise
Incentives matter: How to make planning more flexible and foster good land use?

How land is used

Public policies aimed at steering land use
- Spatial planning
- Transport planning
- Land use planning
- Environmental regulations
- Building code regulations

Public policies not targeted at land use
- Tax policies
- Transport taxes and subsidies
- Fiscal systems and inter-governmental transfers
- Agricultural policies
- Energy policies

How land is permitted to be used

How individuals and businesses want to use land
Key message: Need to pay greater attention to incentives

• By paying greater attention to the incentives that public policy provides for land use, planning can become less restrictive and more effective
• Taxes and fiscal systems matter most
• Regulatory and economic instruments need to be combined

Effective governance mechanisms are a prerequisite for a successful implementation
Effective public investment across levels of government
Public investment is a shared responsibility across levels of government

Share of public investment at subnational level (2014)

Source: OECD national accounts
OECD Recommendation on Effective Public Investment across levels of government

**Pillar 1**
Co-ordinate across governments and policy areas
- Invest using an integrated strategy tailored to different places
- Adopt effective co-ordination instruments across levels of government
- Co-ordinate across SNGs to invest at the relevant scale

**Pillar 2**
Strengthen capacities and promote policy learning across levels of government
- Assess upfront long term impacts and risks
- Encourage stakeholder involvement throughout investment cycle
- Mobilise private actors and financing institutions
- Reinforce the expertise of public officials & institutions
- Focus on results and promote learning

**Pillar 3**
Ensure sound framework conditions at all levels of government
- Develop a fiscal framework adapted to the objectives pursued
- Require sound, transparent financial management
- Promote transparency and strategic use of procurement
- Strive for quality and consistency in regulatory systems across levels of government
Multilevel governance indicators: Australia and the OECD average
Regional policy can improve the performance of cities & regions
Bottom-line

- Regional and rural development policies are important for national productivity growth.
- Policies should enable the use of specific regional assets, create complementarities across sectoral policies, and make use of multi-level governance mechanisms.
- They have to be properly integrated in the structural policy package for inclusive growth.
THANK YOU!